

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

LSP-Kendall Energy, LLC

Docket No. ER06-1131-000

ORDER ACCEPTING AND SUSPENDING RATE SCHEDULE AND ESTABLISHING
HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued August 11, 2006)

1. In this order we accept for filing LSP-Kendall Energy, LLC (Kendall Energy) proposed rate schedule for Reactive Support and Voltage Control from Generation Sources Service (Reactive Power), suspend it for a nominal period, to become effective August 1, 2006, subject to refund and establish hearing and settlement judge procedures.¹ This reactive power rate schedule sets forth the rate that will permit Kendall Energy to recover its cost of providing reactive power in the PJM Interconnection, LLC (PJM) control area.

Background

2. Kendall Energy is an exempt wholesale generator (EWG) authorized to make wholesale power sales at market-based rates.² The Kendall Energy plant is a 1,160 MW

¹ PJM's settlements system can accommodate, without retroactive billing adjustments, effective dates of the first day of the month in which the Commission accepts a generator's reactive power revenue requirements. Accordingly, the Commission has approved such effective dates for reactive power revenue requirements paid pursuant to Schedule 2 of the PJM OATT.

² The Commission granted Kendall Energy EWG status on June 15, 1999, in Docket No. EG99-124-000 *LSP Kendall Energy LLC*, 87 FERC ¶ 62,291 (1999). The Commission granted LSP-Kendall market-based rate authority on June 17, 1999, in Docket No. ER99-2602-000, *Cleco Trading and Marketing LLC, et al.*, 87 FERC ¶ 61,311 (1999).

natural gas-fired combined cycle generating facility located in Kendall County, Illinois (the Facility) and is interconnected with the Commonwealth Edison Company (ComEd) transmission system in the PJM control area.³

Kendall Energy's Filing

3. On June 13, 2006, Kendall Energy filed a rate schedule stating its annual revenue requirement (\$2,936,778) for providing cost-based Reactive Supply and Voltage Control from Generation Sources Service (reactive power) that it will provide to PJM under Rate Schedule No. 2 of PJM's Open Access Transmission Tariff (PJM OATT). Kendall Energy requests an effective date of July 1, 2006.

4. Schedule 2 of PJM's OATT allows generation owners to specify revenue requirements for reactive power and provides that PJM will pay "each generation owner an amount equal to generation owner's monthly revenue requirement as accepted or approved by the Commission."⁴

5. Kendall Energy states it developed its reactive power revenue requirement using three components: (1) a fixed capability component which represents that portion of the plant fixed costs attributed to reactive power production; (2) the heating loss component which allows for recovery of the increased generator heating losses resulting from producing reactive power; and (3) lost opportunity costs in the event the Facility is directed to modify its energy output to produce additional reactive power.⁵

6. Kendall Energy states that because it is a non-utility generator not generally subject to traditional rate regulation and to avoid any potential issues regarding rate of return it has incorporated in its annual carrying cost a conservative rate of return and capital structure based on a proxy, derived from the capital structure and return on equity for ComEd, the owner of the transmission system with which it is connected.

7. Kendall Energy proposes a 12.5 percent rate of return on equity which produces an overall rate of return of 10.32 percent.⁶ Kendall Energy adds that this approach is appropriate for its use because it is a conservative approach as applied to a competitive

³ *PJM Interconnection, LLC (PJM)*, 106 FERC ¶ 61,253 at P 6 (2004).

⁴ PJM, FERC Electric Tariff, Sixth Rev. Vol. 1, First Rev. Sheet No. 229.

⁵ *See PJM*, 106 FERC ¶ 61,127 (2004).

⁶ *See Commonwealth Edison Company, et al.*, 105 FERC ¶ 61,186 (2003) (order conditionally accepting ComEd's filing and establishing hearing and settlement judge procedures).

merchant plant such as Kendall Energy since as a merchant provider it faces greater market risks than those of a monopoly transmission service owner, such as ComEd.⁷

8. With regard to heating losses, Kendall Energy states that when a generator produces reactive power, there are significant heating losses associated with the generator and the generator step-up transformer. Kendall Energy states these losses are the real power consumed to produce reactive power, and consequently, are costs directly attributable to the production of reactive power.

9. Finally, Kendall Energy states, under PJM's OATT, it is entitled to receive lost opportunity costs in the event PJM directs Kendall Energy to restrict its real power output to increase reactive power support to PJM.

Notices and Interventions, Protests and Answer

10. Notice of Kendall Energy's June 13, 2006, filing was published in the *Federal Register*, 71 Fed. Reg. 37,063 (2006), with protests or interventions due on or before July 5, 2006. Constellation Energy Commodities Group, Inc. and Dynegy Power Marketing, Inc. filed motions to intervene. PJM filed a motion to intervene and comment. Exelon Corporation (Exelon) filed a motion to intervene and protest. Kendall Energy filed an answer to PJM's comment and Exelon's protests.

11. PJM notes that Kendall Energy proposed an effective date of July 1, 2006 for its proposed rate schedule. PJM does not oppose this requested effective date, provided that the Commission acts in this matter by July 31, 2006. In the event the Commission does not act by July 31, 2006, PJM requests that the proposed rate schedule and Reactive Power revenue requirements become effective the first day of the month in which the Commission accepts the proposed rate schedule. PJM states that this would prevent retroactive billing and that it routinely requests that the effective date for Reactive Power revenue requirements be the first day of the month after Commission acceptance.

12. Exelon argues that Kendall Energy filing is materially deficient in multiple respects which can only be resolved by means of an evidentiary hearing. Exelon states that it contests all aspects of Kendall Energy's rate and the justness and reasonableness of all aspects of the filing which must be set for hearing.

13. Exelon argues that Kendall Energy has failed to show that the use of the proposed capital cost structure of ComEd, is appropriate. Specifically, Exelon argues that Kendall

⁷Kendall Energy notes that the Commission has accepted proxy rate of returns in several other reactive power filings, such as *Calpine Fox, LLC*, 113 FERC ¶ 61,047 (2005), *Tenaska Virginia Partners*, 107 FERC ¶ 61,207 (2004), and *Duke Energy Fayette, LLC*, 104 FERC ¶ 61,090 (2003).

Energy's support of its proposed capital structure is deficient. Exelon suggest that the proposed weighted average cost, as present by ComEd in Docket No. ER03-1335-000 (2003 filing), could not be the source of an authorized rate of return, because the 2003 filing was resolved through a black-box settlement that did not specific an approved rate of return.⁸ Exelon submits that the use of this proxy is not appropriate because the capital structure employed is unsupported and the ROR used to calculate Kendall Energy's fixed charge rate is too high. Therefore, Exelon concludes that Kendall Energy has failed to show that the 2003 filing capital structure and capital costs is relevant to either ComEd's or Kendall Energy's capital structure and costs.

14. Further, Exelon argues that Kendall Energy's proposed rate uses a single, unexplained administrative and general (A&G) expense item in the amount of \$2,070,116. Exelon contends that Kendall Energy provides no detailed breakdown or substantiation of this claimed expense.

15. Exelon contends that Kendall Energy does not present data in conformance with the Commission's Uniform Systems of Accounts and, as a result, there is no way to determine whether the costs used by Kendall Energy are reasonable comparable to those under the AEP methodology.⁹

16. Exelon also claims that Kendall Energy has miscalculated the fixed charge rate by the use of depreciation expense and plant in service in various derivations.

17. Finally, Exelon argues that Kendall Energy has failed to establish that the power factor used to recovery revenues for heating losses due to reactive power is justified in this instance.

Discussion

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We are not persuaded to accept Kendall Energy's answer, and will therefore reject it.

⁸ Overall rate of return incorporated in Docket No. ER05-1335-000 is 10.32 percent.

⁹ See *American Electric Power Service Corp.*, 88 FERC ¶ 61,141 (1999), *order on reh'g*, 92 FERC ¶ 61,001 (2000); *WPS Westwood Generation, LLC*, 101 FERC ¶ 61,290 at P 14 (2003).

Commission Review

19. As discussed below, we are accepting Kendall Energy's proposed rate schedule for reactive power, suspending it for a nominal period, to become effective August 1, 2006, subject to refund, and establishing hearing and settlement judge procedures. We find that this effective date is consistent with Schedule 2 of PJM's OATT.

20. Kendall Energy proposed to use a 12.50 rate of return and the capital structure as proposed by ComEd in its last rate case in Docket No. ER03-1335-000. Exelon protests the rate return and capital structure proposed by Kendall Energy, contending that the rate of return is unsupported and is based on a black box settlement.

21. We agree with Kendall Energy that as a non-utility generator not generally subject to traditional rate regulation, it can use as a proxy rate of return and capital structure, the accepted rate of return and capital structure of the transmission-owning entity with which the facility is interconnected. The Commission reasoned that a utility's overall rate of return and capital structure is generally conservative compared to a merchant generator, because the market risks faced by the merchant generator are greater than those associated with services provided by a transmission provider like ComEd.¹⁰ However, because ComEd's Docket No. ER03-1335-000 rate case was resolved by a black box settlement that did not specify a rate of return or capital structure,¹¹ we will set for settlement judge and hearing the development of the appropriate rate of return and capital structure consistent with Commission policies.

22. The Commission's preliminary review indicates that Kendall Energy's proposed Reactive Power Service revenue requirement raises issues of material fact. We find that Kendall Energy has failed to show that the proposed rate is just and reasonable, and these issues of material fact cannot be resolved without an evidentiary hearing. Accordingly, the Commission will accept the proposed rates, suspend them for a nominal period, to become effective on August 1, 2006, subject to refund, and set them for hearing.

23. Specific issues of material facts have been raised with respect to the following: (i) whether Kendall Energy's use of ComEd's rate of return of 12.50 percent and capital structure is appropriate, (ii) whether Kendall Energy has failed to include cost data that is consistent with the Commission's Uniform System of Accounts; (iii) whether Kendall Energy has adequate support for its proposed A&G expense, depreciation expense and plant in service derivations; and (iv) whether Kendall Energy has miscalculated the power factor used to calculate revenue requirements for heating losses due to reactive power production.

¹⁰ See, e.g., *Tenaska Virginia Partners*, 107 FERC ¶ 61,207 at P 8 (2004).

¹¹ See *Commonwealth Edison Company, et al.*, 105 FERC ¶ 61,168 (2003).

24. While we are setting these matters for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their disputes before hearing procedures are commenced. To aid the parties in their settlement efforts, the hearing will be held in abeyance and a settlement judge will be appointed pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.¹² If the parties desire, they may, by mutual agreement, request a specific judge as a settlement judge in this proceeding; otherwise the Chief Judge will select a judge for this purpose.¹³ The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for the commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) The proposed rate schedules are hereby accepted for filing, and suspended for a nominal period, to be effective August 1, 2006, subject to refund, as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred on the Federal Energy Regulatory Commission by Section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning the justness and reasonableness of Kendall Energy's proposed reactive power rates. However, the hearing will be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2006), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates

¹² 18 C.F.R. § 385.603 (2006).

¹³ If the parties decide to request a specific judge, they must make their request to the Chief Judge by telephone at 202-502-8500 within five days of the date of this order. The Commission's website contains a listing of Commission judges and a summary of their background and experience (www.ferc.gov - click on Office of Administrative Law Judges).

the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(D) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Chief Judge and the Commission on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter informing the Chief Judge and the Commission of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding administrative law judge, to be designated by the Chief Judge, shall convene a prehearing conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss), as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.